

# **REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE MNQUMA LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the accompanying financial statements of the Mnquma Local Municipality, which comprise the statement of financial position as at 30 June 2011 and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information, and the accounting officer's report, as set out on pages ... to ....

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and General Notice 1111 of 2010 issued in Government Gazette 33872 of 15 December 2010. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

### **Opinion**

7. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Mnquma Local Municipality as at 30 June 2011, and its financial performance and cash flows for the year then ended in accordance with SA Standards of GRAP and the requirements of the MFMA.

**Emphasis of matters**

8. I draw attention to the matters below. My opinion is not modified in respect of these matters:

**Restatement of corresponding figures**

9. Misstatements in the corresponding figures identified during the prior period audit of the financial statements were corrected by management. A number of classes of transaction and account balances were restated, as disclosed in note 32 to the financial statements.

**Irregular expenditure**

10. The municipality incurred irregular expenditure of R528 014, as disclosed in note 38 to the financial statements, as the expenditure incurred was in contravention of Supply Chain Management (SCM) Regulation 44.

**Fruitless and wasteful expenditure**

11. Fruitless and wasteful expenditure of R776 333 was identified by the municipality and adequately disclosed in note 37 to the financial statements.

**Material losses and impairments**

12. The consumer debtors balance before the provision for doubtful debts was R82,6 million. The year-end provision for doubtful debts amounted to R80,1 million, as disclosed in note 9 to the financial statements, including a provision in the current year of R9,8 million.

**REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

13. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the municipality.

**Predetermined objectives****Usefulness of Information**

14. The following criteria are relevant to the findings below:

- Measurability: Indicators are well defined and verifiable, and targets are specific, measurable and time bound.

15. Audit findings:

**Planned and reported targets not specific, measurable and time bound**

- Fifty-one per cent of the planned and reported targets were not specific in clearly identifying the nature and the required level of performance.
- Fifty-four per cent of the planned and reported targets were not measurable in identifying the required performance.
- Fifty-five per cent of the planned and reported targets were not time bound in specifying the time period or deadline for delivery.

### **Planned and reported indicators not well defined**

- For the service delivery objectives, 41% of the planned and reported indicators were not clear, as unambiguous data definitions were not available to allow for data to be collected consistently.

### **Planned and reported Indicators not verifiable**

- For the service delivery objectives, valid performance management processes and systems that produced actual performance against the planned measures did not exist for 41% of the indicators.

### **Reliability of information**

16. The following criteria are relevant to the findings below:

- Validity: Actual reported performance has occurred and pertains to the entity.

17. Audit findings:

#### **Reasons for major variances between planned and actual reported targets not supported by sufficient appropriate evidence**

- Sufficient appropriate evidence to support the reasons for major variances between the planned and the actual reported targets could not be obtained. Sixty-five per cent of the reasons for major variances could not be verified.

#### **Sufficient appropriate evidence to support reported indicators and targets not submitted**

- Sufficient appropriate evidence in relation to certain indicators and targets could not be obtained. There were no satisfactory audit procedures that I could perform to obtain the required assurance as to the validity, accuracy and completeness of the reported performance against predetermined objectives.

### **Compliance with laws and regulations**

#### **Annual financial statements, performance report and annual report**

18. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements in capital assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.
19. The accounting officer did not make public the council's oversight report on the 2009-10 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.
20. The accounting officer did not ensure that the municipality had and maintained an effective, efficient and transparent system of financial and risk management and internal control, as prescribed by section 62(1)(c) of the MFMA.

### **Audit committee**

21. The audit committee did not fulfil all its duties under section 166(2)(a)(v) of the MFMA, as it did not review the performance of the municipality. In addition, internal audit reports relating to the audit of predetermined objectives were not reviewed during the financial year.
22. The audit committee did not approve the annual internal audit plan and audit charter in a timely manner. The annual internal audit plan and audit charter for the year ended 30 June 2011 were approved on 22 November 2010. In addition, there was no evidence to indicate the implementation of an annual internal plan prior to the approval date. There was also no evidence that the audit committee had reviewed the performance management system and made recommendations in this regard as well as submitted reports on performance management to the council.
23. The audit committee functioning as the performance audit committee did not perform the following functions as required by Municipal Planning and Performance Management Regulation 14:
  - Review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality.
  - Review the municipality's performance management system and make recommendations in this regard to the council of the municipality.
  - Submit an auditor's report to the council regarding the performance management system at least twice during the financial year.

### **Internal audit**

24. The internal audit unit did not fulfil all of its duties included in the MFMA. The internal audit unit operated without an audit plan, as required by section 165(2)(a) of the MFMA, until 22 November 2010 when the plan was approved. The internal audit unit did not submit quarterly financial reports on performance measurement to the audit committee for review.

### **Budgetary reporting**

25. The mayor did not always submit a report to the council on the implementation of the budget and the financial state of affairs of the municipality within 30 days of the end of each quarter, as required by section 52(d) of the MFMA.
26. The accounting officer did not submit the approved annual budget to the National Treasury and the provincial treasury within 10 working days after the council had approved the annual budget, as required by section 24(3) of the MFMA. The mayor did not approve the budget implementation plan within 28 days after the approval of the budget, as required by section 53(c)(ii) of the MFMA.
27. The municipal manager did not make public the approved service delivery and budget implementation plan within 10 working days after it had been approved by the mayor and make public the approved adjustment budget within 10 working days after the council had approved the adjustment budget, as per Municipal Budget and Reporting Regulations 19 and 26(1) (GNR 393 of 17 April 2009), respectively.

28. The accounting officer did not submit to the mayor and the provincial treasury a statement of the state of the municipality's budget within 10 working days after the end of each month, as per section 71(1) of the MFMA. Contrary to section 71(2) of the MFMA, the monthly budget statement did not include a projection of revenue and expenditure for the rest of the financial year and any revisions to initial projections.
29. The accounting officer of the municipality did not by 25 January assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72(1)(a)(ii) of the MFMA.
30. The accounting officer of the municipality did not submit the results of the assessment on the performance of the municipality during the first half of the financial year to the mayor of the municipality, the National Treasury and the provincial treasury, as required by section 72(1)(b) of the MFMA.

#### **Expenditure management**

31. The accounting officer did not take reasonable steps to prevent fruitless and wasteful and irregular expenditure, as required by section 62(1)(d) of the MFMA.
32. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
33. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system that recognised expenditure when it was incurred and accounted for the creditors of the municipality, as required by section 65(2)(b) of the MFMA.
34. Input tax on value-added tax (VAT) was claimed in contravention of section 20(4)(c) of the Value-Added Tax Act of South Africa, 1991 (Act No. 89 of 1991), as the municipality did not possess a valid tax invoice in the name of the municipality and which contained the municipal VAT registration number.

#### **Revenue management**

35. Revenue received by the municipality was not always reconciled at least on a weekly basis, as required by section 64(2)(h) of the MFMA.

#### **Procurement and contract management**

36. Awards were made to providers who were persons in the service of other state institutions without the providers declaring that they were in the service of the state, as required by SCM Regulations 44 and 13(c).

#### **Human resource management**

37. In terms of Circular No. 27/2009 issued by the South African Local Government Association, the municipality did not fill all vacant posts on or before 1 August 2010 due to budget constraints.

## **Asset management**

38. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system that accounted for the assets of the municipality, as required by section 63(2)(a) of the MFMA.
39. The accounting officer did not ensure that the municipality had and maintained an effective system of internal control for assets (including an asset register), as required by section 63(2)(c) of the MFMA.

## **INTERNAL CONTROL**

40. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

## **Leadership**

41. The leadership structure at the municipality remained constant during the financial year. Oversight responsibilities over reporting, compliance with laws and regulations and internal control were not adequately exercised and the accounting officer did not evaluate whether management had implemented effective internal controls with regard to the preparation of the financial statements. Management should prepare an adequate working paper file that agrees to the financial statements and ensure that an adequate review is completed to make sure that all the relevant disclosures are made in the financial statements.
42. There was insufficient oversight over the reporting responsibilities regarding compliance with GRAP, laws and regulations as well as auditing in terms of the MFMA. In addition, management did not exercise adequate oversight over reporting on the predetermined objectives of the municipality.
43. The leadership tone at the top refers to the leadership's commitment to create a sound control environment, emphasised by accountability for public funds. An appropriate leadership tone towards financial reporting was displayed, but material adjustments had to be corrected in the financial statements in order to obtain improvements in the audit opinion. Management should prepare adequate reconciliations that agree to the financial statements on a monthly basis.

## **Financial and performance management**

44. A poor control environment over financial reporting existed at the municipality, as extensive manual reconciliations of accounting records and supporting schedules were required at year-end, due to controls not being performed on a regular and timely basis during the year. Adequate reconciliations should be performed on a monthly basis and these should be agreed to the trial balance in order to avoid any discrepancies at year-end.

45. The municipality was unable to provide the auditors with adequate supporting documentation for a number of components of the audit on a timely basis. This was as a result of the municipality not having an adequate record management system for the easy retrieval of documentation. Due to capacity constraints, staff were not able to retrieve documentation timeously. Management should ensure that there are adequate staff to assist with the audit process.
46. A system to monitor compliance with applicable laws and regulations was not in place. As a result, significant non-compliance with the MFMA and other regulations was identified. Management should ensure that all compliance-related documentation is submitted timeously and that the MFMA calendar is strictly adhered to.

#### **Governance**

47. The internal audit unit was not effective in performing its duties and responsibilities in the current year, as it was understaffed. The internal audit unit did also not submit quarterly performance reports to the audit committee. Management should adequately staff the internal audit unit in order for the unit to discharge its duties and responsibilities effectively.
48. The above limitations affected the adequate discharge of the audit committee's duties during the year under review.

*Auditor-General*

East London

30 November 2011



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